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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1935.

No. 283.

BALTIMORE NATIONAL BANK,
Petitioner,

v.

STATE TAX COMMISSION OF MARYLAND,
Respondent.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF MARYLAND.

BRIEF ON BEHALF OF RESPONDENT.

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The Daily Record Co., Print, Baltimore.

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ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF MARYLAND.

BRIEF ON BEHALF OF RESPONDENT.

The opinion of the Court of Appeals of Maryland in the case at bar is reported in 180 Atl. 260, and printed in the Record pp. 25-35. The opinion of the nisi prius Court is printed in the Record pp. 23-24. Reference is also made to the opinion of the Attorney General of Maryland, printed in the Record pp. 13-16.

STATEMENT OF THE CASE.

The brief of the petitioner contains an accurate statement of the case, which need not be here repeated.

THE QUESTION IN CONTROVERSY.

Did the State Tax Commission of Maryland act within its lawful authority in assessing shares of stock in the Baltimore National Bank standing in the name of the Reconstruction Finance Corporation?

The Court of Appeals of Maryland answered this question in the affirmative.

SUMMARY OF ARGUMENT.

I.

The Reconstruction Finance Corporation does not perform an essential governmental function, and therefore Congress cannot exempt from the tax, shares of stock held by it.

A.

State activities, not of an essential governmental character, are subject to Federal taxation.

B.

The principle is reciprocal, and hence Federal activities not of an essential governmental character, are subject to State taxation.

II.

The tax is not such a burden upon the function of the Reconstruction Finance Corporation exercised in this case, as to render the tax unconstitutional.

III.

Congressional consent to the tax may be implied from the provisions of the National Banking Act.

SUMMARY OF APPLICABLE STATUTES.

STATE.

Section 6 of Chapter 226 of the Acts of 1929, Bagby's Annotated Code of Public General Laws of Maryland, 1929 Supplement, Article 81, Section 6 (6) reads in part as follows:

> "6. The following property * * * shall be subject to assessment to the owner and taxation for ordinary taxes in this State and in the county and/or city specified below: * * *
>
> (6) All shares of stock in any national bank situated in this State, in the county and/or city where the holders thereof respectively reside, or if they be non-residents of this State, in the county and/or city in which the principal office of such bank is situated."

Section 10 of said article provides:

> "The following shall be valued and assessed for purposes of State, county and/or city taxation by the State Tax Commission: (1) shares of stock subject to taxation under this Article in any national bank located in this State * * *".

Section 15 of said Article reads in part as follows:

> "(e) Shares of stock assessable under this Section shall be taxed to the several owners thereof, and the taxes thereon shall be debts of such owners, but may be collected in each case from the bank * * *, which shall be bound to pay the same for account of its stockholders whether or not dividends are declared thereon, as if such corporations were the ultimate taxpayer, but may obtain reimbursement therefor from the respective stockholders, and may charge the same in reduction of any amounts due to the several shareholders as dividends or otherwise."

Section 7 of said Article provides:

"The following shall be exempt from assessment and from State, County and City taxation in this State, each and all of which exemptions shall be strictly construed: * * *

Subsection (22). Any property exempted from taxation by this State by the Constitution of the United States or by any Act of Congress passed pursuant to and in conformity with the Constitution of the United States."

FEDERAL.

(National Banking Act.)

R. S. Sec. 5219, U. S. C. A. Title 12, Sec. 548, as amended by the Act of Congress of March 25th, 1926, provides:

"The Legislature of each State may determine and direct, subject to the provisions of this section, the manner and place of taxing all the shares of national banking associations within its limits. The several States may (1) tax said shares, or (2) include dividends derived therefrom in the taxable income of an owner or holder thereof, or (3) tax such associations on their net income, or (4) according to or measured by their net income, provided the following conditions are complied with:

(a) The imposition by any State of any one of the above four forms of taxation shall be in lieu of the others, except as hereinafter provided in sub-division (c) of this clause.

(b) In the case of a tax on said shares the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks: * * *

(c) In case of a tax on or according to or measured by the net income of an association, the taxing State may, except in case of a tax on net income, in-

clude the entire net income received from all sources, but the rate shall not be higher than the rate assessed upon other financial corporations. * * *

By an amendment to the National Banking Act of March 9, 1933, c. 1, section 304, 48 Stat. 6 as amended by Act of March 24, 1934, c. 8, Sec. 2, 48 Stat. 20; U. S. C. A. Title 12, Sec. 51(d), it is provided:

"Sec. 51D. *Preferred stock; subscription by Reconstruction Finance Corporation; sale of stock.* If in the opinion of the Secretary of the Treasury any national banking association or any State bank or trust company is in need of funds for capital purposes either in connection with the organization or reorganization of such association, State bank or trust company or otherwise, he may, with the approval of the President, request the Reconstruction Finance Corporation to subscribe for preferred stock in such association, State bank or trust company, or to make loans secured by such stock as collateral, and the Reconstruction Finance Corporation may comply with such request. * * * The Reconstruction Finance Corporation may, with the approval of the Secretary of the Treasury, and under such rules and regulations as he may prescribe, sell in the open market the whole or any part of the preferred stock, capital notes, or debentures of any national banking association, State bank or trust company acquired by the corporation pursuant to this section. The amount of notes, bonds, debentures, and other such obligations which the Reconstruction Finance Corporation is authorized and empowered to issue and to have outstanding at any one time under existing law is hereby increased by an amount sufficient to carry out the provisions of this section. As used in this section, the term 'State bank or trust company,' shall include other banking corporations engaged in the business of industrial banking and under the supervision of State banking departments or of the Comptroller of the Currency."

(Reconstruction Finance Corporation Act)

The Reconstruction Finance Corporation was created by an Act of Congress of January 22nd, 1932, 47 Stat. 9; U. S. C. A. Title 15, Sec. 601.

Section 605 (Tit. 15 U. S. C. A.) empowered the corporation:

> "To aid in financing agriculture, commerce, and industry, including facilitating the exportation of agricultural and other products, the Corporation is authorized and empowered to make loans, upon such terms and conditions not inconsistent with this chapter as it may determine, to any bank, savings bank, trust company, building and loan association, insurance company, mortgage-loan company, credit union, Federal Land Bank, joint-stock land bank, Federal intermediate credit bank, agricultural credit corporation, livestock credit corporation, organized under the laws of any State or of the United States, * * *
>
> All loans made under the foregoing provisions shall be fully and adequately secured. * * *"

By succeeding Sections, loans to States, municipalities, and other public and private agencies were authorized.

By Sec. 605 (e), the purchase of stock in insurance companies was authorized.

By Sec. 605 (b) loans were authorized "to any industrial or commercial business which shall include the fishing industry, established prior to January 1, 1934."

Sec. 606(d) authorized loans to those engaged in the business of mining, milling or smelting of ores.

By Sec. 609(a) the corporation was authorized to have outstanding obligations at any one time, equal to 6 3/5 times its aggregate capital stock of $500,000,000.

By Sec. 609(d) the corporation was authorized to purchase "marketable securities, satisfactory to said corporation, acquired or to be acquired by the Federal Emergency Administration of Public Works," not to exceed $250,000,000.

Finally, Section 610 of said Act provides:

> "The corporation, including its franchise, its capital, reserves, and surplus, and its income shall be exempt from all taxation now or hereafter imposed by the United States, or by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that any real property of the corporation shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed."

ARGUMENT.

I.

THE R. F. C. DOES NOT PERFORM AN ESSENTIAL GOVERNMENTAL FUNCTION, AND THEREFORE CONGRESS CANNOT EXEMPT FROM THE TAX, SHARES OF STOCK HELD BY IT.

In the leading case of *McCulloch vs. Maryland*, 4 Wheat. 316, Chief Justice Marshall stated the first question to be: "has Congress power to incorporate a bank?"

In the same way, it might be urged that the first question in the case at bar is whether Congress had power through the Reconstruction Finance Corporation to participate with private stockholders in the ownership and

conduct of a national bank and the other business enterprises mentioned in the Act of Congress creating said corporation.

It cannot be denied that the mere lending of money to industry has heretofore been exclusively a private, and not a public function, much less a function of the Federal Government. The power conferred upon the Reconstruction Finance Corporation to lend money "to aid in financing agriculture, commerce and industry" carries with it the potentiality that the Federal Government, in order to prevent wholesale bankruptcies in times of economic depression, may ultimately acquire complete control of all business enterprise, and "nationalize" all production. Nor is this aim denied by the exponents of a "planned economy". As this Court said in the case of *Schecter vs. U. S.*, 79 L. Ed. 888, 906: "The recuperative efforts of the Federal Government must be made in a manner consistent with the authority granted by the Constitution."

The question was suggested, but not pressed in the argument of the case below, and Chief Judge Bond, speaking for the Court of Appeals of Maryland, said:

> "As the point was not pressed, we proceed upon the assumption that the stock is validly held." (R. p. 27).

But assuming for the purposes of this case, the Constitutional power of Congress to authorize the acquisition of stock by its agent, it by no means follows that the property so held by the agent is thereby entitled to immunity from State taxation.

A.

State Activities, Not of an Essential Governmental Character, Are Subject to Federal Taxation.

This proposition finds abundant support in the decisions of this Court.

In the case of *South Carolina vs. U. S.*, 199 U. S. 437, the State of South Carolina established a liquor dispensary system, all of the profits of which enured to the State. The United States sought to collect the Federal license tax prescribed by the Internal Revenue Act for dealers in intoxicating liquors. In sustaining the tax, Mr. Justice Brewer, speaking for this Court, said:

> "The profits from the business in the year 1901, as appears from the findings of fact were over half a million of dollars. Mingling the thought of profit with the necessity of regulation may induce the state to take possession, in like manner, of tobacco, oleomargarine, and all other objects of internal revenue tax. If one state finds it thus profitable, other states may follow, and the whole body of internal revenue tax be thus stricken down.
>
> "More than this. There is a large and growing movement in the country in favor of the acquisition and management by the public of what are termed 'public utilities', including not merely therein the supply of gas and water, but also the entire railroad system. Would the state, by taking into possession these public utilities, lose its republican form of government?
>
> "We may go even a step further. There are some insisting that the state shall become the owner of all property and the manager of all property and the manager of all business. Of course, this is an extreme view, but its advocates are earnestly contending that thereby the best interests of all citizens will be subserved. If this change should be

made in any state, how much would that state contribute to the revenue of the nation? If this extreme action is not to be counted among the probabilities, consider the result of one much less so. Suppose a state assumes, under its police power, the control of all those matters subject to the internal revenue tax, and also engages in the business of importing all foreign goods. The same argument which would exempt the sale by a state of liquor, tobacco, etc. from a license tax, would exempt the importation of merchandise by a state from import duty. While the state might not prohibit importations, as it can the sale of liquor, by private individuals, yet, paying no import duty, it could undersell all individuals, and so monopolize the importation and sale of foreign goods.

"Obviously, if the power of the state is carried to the extent suggested, and with it is relief from all Federal taxation, the national government would be largely crippled in its revenues. Indeed, if all the states should concur in exercising their powers to the full extent, it would be almost impossible for the nation to collect any revenues. In other words, in this indirect way it would be within the competency of the states to practically destroy the efficiency of the national government."

In a period such as the present, the fears expressed by the Court as to the possible effect of State expansion upon Federal revenue, may justly be applied to the unprecedented expansion of Federal activity in the field of private business.

Commenting upon its former decision, this Court in *Flint vs. Stone-Tracy Co.*, 220 U. S. 107, said:

"The exemption of State agencies and instrumentalities from national taxation was limited to those of a strictly governmental character, and did not extend to those used by the State in carrying on business of a private character."

In *University of Illinois vs. U. S.*, 289 U. S. 48, 59, this Court rejected a State university's claim, that to impose duties on scientific apparatus, imported for necessary use in the exercise of its educational function, was unconstitutional.

In *Ohio vs. Helvering*, 292 U. S. 360, another State liquor monopoly case, this Court said:

> "By the very terms of the rule, the immunity of the States from Federal taxation is limited to those agencies which are of a governmental character. Whenever a State engages in a business of a private nature it exercises non-governmental functions, and the business, though conducted by the State, is not immune from the exercise of the power of taxation which the Constitution vests in Congress * * *.
>
> "The argument seems to be that the police power is elastic and capable of development and change to meet changing conditions. Nevertheless, the police power is and remains a governmental power, and applied to business activities is the power to regulate those activities, not to engage in carrying them on. If a state chooses to go into the business of buying and selling commodities, its rights to do so may be conceded so far as the federal Constitution is concerned; but the exercise of the right is not the performance of a governmental function, and must find its support in some authority apart from the police power. When a state enters the market place seeking customers it divests itself of its quasi sovereignty pro tanto, and takes on the character of a trader, so far, at least, as the taxing power of the Federal Government is concerned".

In *Helvering v. Powers*, 294 U. S. —; 79 L. Ed. 141, this Court speaking through the present Chief Justice, unanimously decided that the compensation of public officers operating the Boston Elevated Railway Company under a State statute, on behalf of the Commonwealth of Mas-

sachusetts, was not exempt from Federal taxation, although the validity of the statute had previously "been sustained as one enacted for a public purpose and providing for the management of the enterprise by the Commonwealth".

Boston v. Jackson, 260 U. S. 309;
Boston v. Treasurer, 237 Mass. 403.

This Court said:

"Whether that field of activity in relation to a State, carries immunity from federal taxation is a question which compels consideration of the nature of the activity, apart from the mere creation of offices for conducting it, and of the fundamental reason for denying federal authority to tax. That reason, as we have frequently said, is found in the necessary protection of the independence of the national and state governments within their respective spheres under our constitutional system. * * * The principle of immunity thus has inherent limitations. * * * And one of these limitations is that the State cannot withdraw sources of revenue from the federal taxing power by engaging in businesses which constitute a departure from usual governmental functions and to which, by reason of their nature, the federal taxing power would normally extend. The fact that the State has power to undertake such enterprises, and that they are undertaken for what the State conceives to be the public benefit, does not establish immunity. * * * The necessary protection of the independence of the state government is not deemed to go so far. * * *

"* * * the State, with its own conception of public advantage, is undertaking a business enterprise of a sort that is normally within the reach of the federal taxing power and is distinct from the usual governmental functions that are immune from federal taxation in order to safeguard the necessary independence of the State. If, in the instant case, the

> Commonwealth had acquired the property of the Company and had organized management of it in perpetuity by the state government, instead of temporarily, or had taken over all the street railways in all its cities for direct operation by the Commonwealth, there would appear to be no ground, under the principles established by the decisions we have cited, for holding that this would effect the withdrawal of the enterprise from the federal taxing power. And the fact that the State has here undertaken public management and operation for a limited time, and under the particular restrictions of the agreement with the Company, cannot be said to furnish a ground for immunity."

In the case of *North Dakota v. Olson,* 33 Fed. (2) 848, (C. C. A. 8th Cir.) (appeal dismissed 280 U. S. 528, 74 L. Ed. 594) the State of North Dakota incorporated a bank of its own for the purpose of encouraging and promoting agriculture, commerce and industry. Its capital of $2,000,000 was supplied by the State, all the stock was owned by the State, and the Bank was managed by a board of directors composed of the State Governor, Attorney General and Commissioner of Agriculture and Labor. The title of the Act creating the Bank read:

> "For the purpose of encouraging and promoting agriculture and industry the State of North Dakota shall engage in the business of banking, and for that purpose does hereby establish a bank under the name of the 'Bank of North Dakota'."

The Bank was held subject to national taxation upon its capital stock.

The principle underlying all of these decisions has been consistently adhered to by this Court, and cannot now be questioned.

B.

The Principle Is Reciprocal, and Hence Federal Activities Not of an Essential Governmental Character, Are Subject to State Taxation.

The reciprocal nature of the principle was recognized in the case of *South Carolina v. U. S.*, supra, where the Court said:

> "The exemption of the State's property and its functions from Federal taxation is implied from the dual character of our Federal system and the necessity of preserving the State in all its efficiency".

Indeed, the necessary mutuality of the principle, and its possible effect on Federal activities, was the chief ground of dissent.

Mr. Justice White, in his dissenting opinion, said: (p. 464):

> " * * * the decision now made, as it is by me understood, overrules many cases, departs from a principle which has been recognized from the beginning, and, under the assumed necessity of protecting the taxing power of the government of the United States, establishes a doctrine which, in its potentiality, strips the states of their lawful authority. It does more than this, since the theory upon which the case is decided also endows the states with a like power to divest the government of the United States of its lawful attributes. In other words, by the ruling and the reasoning sustaining it, the distinct powers belonging to both the national and state governments are reciprocally placed the one at the mercy of the other, so as to give to each the potency of destroying the other * * *."

In *Metcalf v. Mitchell,* 269 U. S. 514, 521, this Court said:

> "The very nature of our constitutional system of dual sovereign governments is such as impliedly to

prohibit the Federal government from taxing the instrumentalities of a State government, and in a similar manner to limit the power of the States to tax the instrumentalities of the Federal government. * * *

"The limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation cannot be so varied or extended as seriously to impair either the taxing power of the government imposing the tax, or the appropriate exercise of the functions of the government affected by it."

"In one aspect the extent of the exemption must finally depend upon the effect of the tax upon the functions of the government alleged to be affected by it."

Again, in *Fox Film Corp. v. Doyal,* 286 U. S. 123, 128, this Court said:

"The principle of the immunity from State taxation of instrumentalities of the Federal Government, and of the *corresponding immunity* of State instrumentalities from Federal taxation—essential to the maintenance of our dual system—has its inherent limitations. It is aimed, at the protection of the *operations of government,* and the immunity does not extend to anything lying outside or beyond *governmental functions* and their exertions." (Italics ours).

The principle was fully recognized by this Court in its latest pronouncement on the point in *Helvering v. Powers,* supra.

If the principle is reciprocal, every decision of this Court, cited under A, above, is directly in point upon the question presented in the case at bar.

The Federal tax upon the capital stock of the Bank of North Dakota fell directly upon shares all of which were owned by the State, for its fiscal purposes. Thus the primary purpose of the bank was to carry out a governmental function, but because such a purpose was not usual or essential to the operations of government, the plea of sovereign immunity did not prevail. In the liquor dispensary cases cited above, all of the capital was supplied by the States, but this did not affect the liability to taxation.

It is wholly immaterial that the stock in the case at bar was issued by a National Bank; immunity depends solely on the character of the investing agent, the Reconstruction Finance Corporation.

As Chief Judge Bond said (R. p. 29):

> "It is a question of immunity attaching to a particular stockholder as distinguished from the banking corporation itself. The fact that the bank, too, is a governmental agency, and enjoys immunity for property owned by it, has now no bearing. The immunity to be considered is one which would likewise apply if the shares were those of a state bank or trust company. * * *"

It can hardly be pretended that the investment of funds in bank stock is not a proprietory act. In its brief filed in the Court of Appeals below, the petitioner said:

> "National banks are distinctly private corporations, organized under a general law of Congress by individual shareholders who contribute their own money for private gain."

In *Osborn v. Bank of U. S.*, 9 Wheat. 738, Chief Justice Marshall, commenting upon his former opinion, said:

> "That the mere business of banking is, in its own nature, a private business, and may be carried on

by individuals or companies having no political connection with the government, is admitted."

A further point may be noticed. The ownership of the Reconstruction Finance Corporation is not the ownership of the Federal government, but merely of an agency thereof. The distinction was clearly pointed out by Chief Judge Bond in the Court below:

> "For extending the aid to industries determined upon for the period of the depression, the national government, assuming all necessary constitutional powers, could as pointed out in argument have used ordinary departmental executives or officers, without creating a corporation for the work. And the aid might have been extended by gifts or loans. Loans might have been secured by pledges of stock or other property. Always the government would have stood apart, not participating in the business. But a corporation was decided upon as an agency. And instead of making direct gifts, or loans, it was authorized (U. S. C. A., Tit. 12, Sec. 51D) to subscribe to preferred stock in corporations aided, at least when under state laws such stock could be taken free of double liability. The preferred stock is taken with the incidental right to profits, and actual conduct of the business may be taken over. To a greater or less extent the Finance Corporation has been placed in the position of partner in the business aided, whatever that business may be. U. S. C. A., Tit. 12, Secs. 601, 605, 609, etc.; *Cont. Ill. Nat. Bank v. Chicago, R. I. & Pac. Co.*, 294 U. S.—, 79 L. ed. 642; *Bassett v. Merchants Trust Co.*, 115 Conn. 530, 538."

That the Reconstruction Finance Corporation does not enjoy all the prerogatives of the Government clearly appears from the decision of this Court, *Cont. Ill. Nat. Bk. v. C. R. I & Pac. Co.*, supra.:

> "The Reconstruction Finance Corporation Act creates a corporation and vests it with designated

powers. Its entire capital stock is subscribed by the government, but it is nevertheless a corporation, limited by its charter and by the general law. The Act does not give it greater rights as to the enforcement of its outstanding credits than are enjoyed by other persons or corporations in the event of proceedings under the Bankruptcy Act. The provisions and principles of the Bankruptcy Act, including Sec. 77, are binding upon the Reconstruction Finance Corporation in the absence of some pertinent statutory provision as they are upon other corporations * * *".

In *Bank of U. S. v. Planters Bank of Georgia*, 9 Wheat. 904, 907, Chief Justice Marshall said:

"The planters Bank of Georgia is not the State of Georgia, although the State holds an interest in it. It is, we think, a sound principle, that when a government becomes a partner in any trading company, it diverts itself, so far as concerns the transactions of that company of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those it associates itself, and takes the character which belongs to its associates, and to the business which is to be transacted. * * * As a member of a corporation, a government never exercises its sovereignty * * *. *The government of the union held shares in the old Bank of the United States; but the privileges of the government were not imparted by that circumstance to the Bank.* * * * The government, by becoming a corporator lays down its sovereignty, so far as respects the transactions of the corporation, and exercises no power or privilege which is not derived from the charter." (Italics ours.)

In *National Home v. Parrish*, 229 U. S. 494, it was held that the exemption of the government from payment of interest on claims against it did not extend to an incor-

porated soldiers' home, although it was under the ultimate supervision of Congress, and disbursed money supplied by the government for its support and maintenance.

Property of the government saved from destruction at sea by salvors is held liable to contribution in general average.

The Davis, 10 Wall. 15;

and see

United States v. Strang, 254 U. S. 491;
Salas v. U. S., 234 Fed. 842;
Standard Oil Co. v. U. S., 267 U. S. 76, 79.

Immunity of corporate government agencies from suit and judicial process and their incidents, is not readily implied.

Federal Land Bank v. Priddy, 294 U. S. 79
L. Ed. 709, 713.

In *Hopkins Federal State Loan Association v. Cleary*, Supreme Court No. 55, 7 Oct. Term, 1935, decided December 9, 1935, this Court held that the Home Owners Loan Act, to the extent that it permits the conversion of State associations into Federal ones in contravention of the laws of the place of their creation, is an unconstitutional encroachment upon the reserved powers of the States.

The Court said:

> "We find it needless to consider whether Congress has the power to create building and loan associations and thereupon invest them with corporate capacity. As to that we do not indicate an opinion either one way or the other * * *".

"The destruction of associations established by a State is not an exercise of power reasonably necessary for the maintenance by the central government of other associations created by itself in furtherance of kindred ends".

Yet, if we assume such Federal associations to possess the right of immunity from taxation, can they not preempt this field of activity, through the enjoyment of a competitive advantage, and thus indirectly encroach upon the reserved powers of the States?

The Reconstruction Finance Corporation does not appear to be anything more than a lending agency to assist in the recuperation of private industry.

It is clearly distinguishable from those Federal agencies created by Congress in 1918 under the war power, cited by the petitioner.

In *Clallam County v. U. S.*, 263 U. S. 341, 343, it was held that the property of the United States Spruce Production Corporation, organized by the United States as an instrumentality for producing aeroplane lumber to carry on the war, was exempt from State taxation. The Court, speaking through Mr. Justice Holmes, said:

"The state claims the right to tax on the ground that taxation of the agency may be taxation of the means employed by the government, and invalid upon admitted grounds; but that taxation of the property of the agent is not taxation of the means. We agree that it 'is not always, or generally, taxation of the means,' as said by Chief Justice Chase in *Thomson v. Union P. R. Co.* 9 Wall. 579, 591, 19 L. ed. 792, 798. But it may be, and, in our opinion, clearly is, when, as here, not only the agent was created, but all the agent's property was acquired and used, *for the sole purpose of producing a weapon for the war*. This is not like the case of a corpora-

tion having its own purposes as well as those of the United States, and interested in profit on its own account. The incorporation and formal erection of a new personality was only for the convenience of the United States, to carry out its ends. *It is unnecessary to consider whether the fact that the United States owned all the stock and furnished all the property to the corporation, taken by itself, would be enough to bring the case within the policy of the rule that exempts property of the United States. Van Brocklin v. Tennessee* (*Van Brocklin v. Anderson*) 117 U. S. 151, 29 L. ed. 845, 6 Sup. Ct. Rep. 670. It may be that if the United States saw fit to avail itself of machinery furnished by the state, it would not escape the tax on that ground alone. But when we add the facts that we have recited, we think it too plain for further argument that the tax could not be imposed". (Italics ours.)

In the last analysis, the petitioner's position seems to be, that the Federal authority being supreme, a different rule must be applied to Federal activities than is applied to State activities, wholly disregarding the foregoing principles. If that be the rule, and Congress possesses the constitutional power to launch the government into fields heretofore considered private, then the sovereignty of the States in our dual system, will be progressively diminished. Tax receipts all come from the same source, namely the income and profits of the American people. If by the mere entry into those fields of Federal corporations, of which the Reconstruction Finance Corporation is only one, and the investment of Federal funds therein, exemption from State taxes follows as a necessary consequence, the ability of the States to maintain themselves will be seriously abridged, both by the removal of such property from State jurisdiction to tax and by the burden of Federal taxes necessary for Federal investment, which will dry up the reservoir out of

which all taxes must be drawn. If the States are to endure as sovereign bodies, a limitation must be found in the application of the rules as to proprietory, as distinguished from governmental, activities heretofore invoked in the case of State expansion into novel fields of public ownership.

II.

THE TAX IS NOT SUCH A BURDEN UPON THE FUNCTION OF THE RECONSTRUCTION FINANCE CORPORATION EXERCISED IN THIS CASE, AS TO RENDER THE TAX UNCONSTITUTIONAL.

Petitioner argues that the burden, no matter how slight, renders the tax invalid. But this conclusion is not borne out by the decisions of this Court. The tendency of the decisions has been away from a doctrinal approach, which would condemn a tax falling in any degree upon a government instrumentality, towards an analysis which may condone a tax whose burden upon the function is slight.

Although a tax upon the real estate of a national bank is a burden upon its operation *pro tanto*, the States are not prohibited from taxing such real estate by the Federal Constitution. The same thing is true of the shares issued by such banks.

In *McCulloch v. Maryland*, supra, Chief Justice Marshall said:

> "This opinion does not deprive the States of any power which they originally possessed. It does not extend to a tax paid by the real property of the bank, in common with other real property within the State, nor a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the State."

This is a recognition, by the leading authority on the point, that a non-discriminatory tax on real estate or shares, is not such a burden as to obstruct the accomplishment of the Federal purposes for which the bank was created; purposes which at that time were almost wholly concerned with the carrying out of Federal fiscal policies, rather than the earning of private profits.

In *Susquehanna Power Co. v. State Tax Commission,* 159 Md. 334, 343 (affirmed 283 U. S. 291), the Maryland Court of Appeals, speaking through Judge Offutt, said:

> "While it is axiomatic that no tax may be imposed by a State upon property of the Federal government, or upon agencies of that government, when the effect of the tax would be to impair the efficiency of such agencies 'in performing the functions by which they serve' it (*Cooley on 'Taxation',* 4th Ed. 606, 607), that exemption does not exist in the absence of the reasons for the rule. So that the right of the Power Company to have its property in this State exempted from taxation by the State depends upon two factors; one, whether it is a federal agency, and the other whether, if it is, such a tax would impair its efficiency in discharging functions by which it serves the federal government."

In *Indian Territory Illuminating Oil Co. v. Tulsa Co. Bd. Equalization,* 288 U. S. 325, it was held that State taxation of oil produced from Indian lands under lease approved by the Secretary of the Interior, for which a royalty was paid, was not invalid. The Court said:

> "There is a recognized distinction between a non-discriminatory tax upon the property of an agent of the government, albeit the property is used in, or has relation to, the business of the agency where there is only a remote, if any influence upon the exercise of the functions of government—and a tax which is deemed to impose a direct burden upon the

exertion of governmental powers. * * * Such immunity as petitioner enjoyed as a governmental instrumentality inhered in its operations as such, and being for the protection of the government in its function extended no further than was necessary for that purpose".

In *Federal Compress Co. v. McLean*, 291 U. S., 17, this Court said:

> "The tax upon petitioner's business, applied without discrimination to all similar businesses whether licensed or not, does not impair the control which the Federal authority has chosen to exert. The mere extension of control over a business by the national government does not withdraw it from a local tax which presents no obstacle to the execution of the National policy".

In *Fox Film v. Doyal*, 286 U. S. 123 (overruling *Long v. Rockwood*, 277 U. S. 142), it was held that a State could tax income received as royalties for the use of patents. Upon the same principle, Federal power and warehouse licensees are not immune from a tax upon the gross receipts of royalties under, or an excise tax upon the privilege of operating under, Federal licenses, although they may represent a means of Federal control.

Broad River Power Co. v. Query, 288 U. S. 178;
Federal Compress v. McLean, supra.

Nor is the property of a Federal licensee exempt.

Susquehanna Power v. State Tax Commission, 283 U. S. 291;

In *Trinity Farm Constr. Co. v. Grosjean*, 291 U. S. 466, it was held that a State excise tax on gasoline consumed by a contractor with the United States in constructing

levees, was not an unconstitutional taxation of means or instrumentalities of the United States.

In *Pan Am. Petr. v. Ala.*, 67F (2) 590 (C. C. A. 5th) (Certiorari denied 291 U. S. 670), it was held that army post exchanges are not governmental agencies and hence are properly subject to a gasoline tax. The same question was argued in *Standard Oil Co. v. Cal.*, 291 U. S. 241, but the case was decided on another ground.

Similarly, income received by a contractor under a State contract is subject to the Federal income tax.

Metcalf v. Eddy, 269 U. S. 514.

Compare:

Baltimore Shipb. v. Baltimore, 195 U. S. 375.

In the case at bar the incidence of the tax is upon the earnings of the bank, which is bound to pay the same "whether or not dividends are declared thereon, as if such corporation were the ultimate taxpayer." Sec. 15(e), Art. 81, Md. Code.

The payment of the tax does not interfere with the policy of the government "to aid in financing agriculture, commerce and industry * * *". The only conceivable effect the payment of the tax might have upon the Reconstruction Finance Corporation would be to diminish, pro tanto, the income from dividends, if the tax were not assumed by the Bank. We find nothing in the Federal or Maryland statutes to prevent the bank from assuming such tax; indeed, it would appear to be the general practice. In a memorandum prepared by Mr. Fitts, special counsel to the Reconstruction Finance Corporation, under date of Feb. 10th, 1934, it was said:

> "While we cannot speak authoritatively or with certainty, we have been led to believe that as a general rule the banks pay the taxes and make no attempt to seek reimbursement."

The realization of income or profits from the investment is purely incidental to the primary purpose of the Federal agency. Such slight burden as the tax may impose upon property in which the Reconstruction Finance Corporation has an interest, can hardly be said to amount to an interference "with the execution of the national policy".

As Chief Judge Bond in the Court below said:

> "We have been unable to see that taxing these shares as usual may, because of the nature and constitution of the agency owning them interfere with the governing function of the national sovereignty, or carry any possibility of interference. On the contrary, it seems to us that the particular agency is, in the words of the Supreme Court, "engaging in a business which constitutes a departure from usual governmental functions. *Helvering v. Powers,* 294 U. S. —; 79 L. ed. 141."

III.

CONGRESSIONAL CONSENT TO THE TAX MAY BE IMPLIED FROM THE PROVISIONS OF THE NATIONAL BANKING ACT.

From the summary of applicable statutes, cited above, it clearly appears that the Maryland law authorizes the assessment of the shares in question. The petitioner concedes that the exemption in the Maryland statutes, Section 7 (22) of Art. 81, confers no greater exemption than the Federal constitution requires, and only refers the question to Federal law. It is further conceded that Congress may, for reasons it may deem sufficient, consent to imposition of the tax.

Can congressional consent be implied from the Federal statutes?

The Federal statutes relating to National Banks represent the result of a long process of trial and error, and the primary purpose behind the enactment of Sec. 548 (R. S. 5219) was to equalize the competitive positions of the Federal and State banks, respectively.

First National Bank v. Chapman, 173 U. S. 205.

Moreover, the National Banking Act, as last amended by an Act of Congress of March 25th, 1926, expressly confers upon the States the power to tax "all the shares of national banking associations" located within their jurisdictions, and makes no exceptions or distinctions among stockholders, governmental or otherwise.

An exemption of the bank stock held by the Reconstruction Finance Corporation would be by way of an exception to this general statutory permission.

Petitioner argues that such an exception is to be found in the language of the act of Congress creating the Reconstruction Finance Corporation that "the corporation, including its franchise, its capital, reserves and surplus, and its income shall be exempt from all taxation * * * except that any real property of the corporation shall be subject" to taxation.

As Chief Judge Bond remarked:

> "But this seems to be no more than the exemption applicable to federal agencies generally under the decision in *McCulloch v. Maryland*, 4 Wheaton, 316, and although a national bank enjoys the like exemption for its property, it has been held that this does not withdraw from state taxation under sec-

tion 548 of the Banking Act [R. S. 5219] stock which one national bank may hold in another. *Nat. Bank of Redemption v. Boston*, 125 U. S. 60; *Bank of California v. Richardson*, 248 U. S. 476, 483; *Bank of California v. Roberts*, 248 U. S. 497. • • •"

In the case first cited, referring to Section 548 (R. S. Sec. 5219) the Court said:

> "It is contended that no tax is hereby authorized upon the national bank itself as a corporation, nor upon the personal property of any such, and that, therefore, these shares in the National Bank of Redemption are exempt from taxation by virtue of their ownership. This, however, is not a reasonable interpretation of the language of the section. The manifest intention of the law is to permit the State in which a national bank is located to tax, subject to the limitations prescribed, *all the shares of its capital stock without regard to their ownership.* The proper inference is that the law permits, in the particular instance, the taxation of the national banks owning shares of the capital stock of another national bank by reason of that ownership, on the same footing with all other shares." (Italics ours.)

In *Bank of California v. Richardson*, 248 U. S. 476, 483, it was said:

> " 'Two provisions in apparent conflict were adopted. First, the absolute exclusion of power in the states to tax the banks, the national agencies created, so as to prevent all interference with their operations, the integrity of their assets, or the administrative governmental control over their affairs. Second, preservation of the taxing power of the several states so as to prevent any impairment thereof from arising from the existence of the national agencies created, to the end that the financial resources engaged in their development might not be withdrawn from the reach of state taxation, but on the contrary that *every resource possessed by the banks*

as national agencies might in substance and effect remain liable to state taxation.

> "'The first aim was attained by the non-recognition of any power whatever in the states to tax the federal agencies, the banks, except as to real estate specially provided for, and, therefore, the exclusion of all such powers. The second was reached by a recognition of the fact that, considered from the point of view of ultimate and beneficial interest, every available asset possessed or enjoyed by the banks would be owned by their stockholders, and would be, therefore reached by taxation of the stockholders as such". (Italics ours.)

In the same way it has been held that shares of stock in a Federal Reserve Bank, held by a national bank, are taxable, *Cincinnati First Nat. Bank v. Beaman*, 257 F. 729 (C. C. A. 6th).

The Federal statutes cited above must be construed in pari materia. The Act creating the Reconstruction Finance Corporation exempts from taxation the corporation, its franchise, its capital reserves and surplus and its income, but permits it to be taxed upon its real estate. The terms of this exemption follow closely the terms of the exemption granted to national banks, and yet the property exemption enjoyed by a national bank does not extend to shares of national bank stock held by it. A broad power to tax national bank shares is conferred by Section 548 (R. S. 5219), and this power is not limited or qualified by the provisions of Section 610 of the R. F. C. Act.

The avowed purpose of the Reconstruction Finance Corporation is not to compete with any private industrial enterprise, but to prevent the liquidation of such enterprise through bankruptcy or otherwise. If, however, the Bank which receives Reconstruction Finance Corporation funds is relieved from payment of the tax, whereas

a Bank receiving funds from private sources must pay the tax, then clearly the former is in a more favorable competitive position; treating the tax as an operating cost, the former is in a position to enjoy a larger margin of profit.

Can it be supposed that Congress intended to create a situation of this kind, which would tend to increase the demands of banks and other institutions for Reconstruction Finance Corporation funds, and discourage resort to traditional private channels, or, in the alternative, enable the Reconstruction Finance Corporation to enjoy a greater return than private investors, by reason of its tax immunity?

The construction put upon the Federal statutes by the petitioner would not only create competitive inequalities, and unduly favor banks fortunate enough to obtain stock subscriptions from the federal agency; it would operate to the prejudice of those States which have elected to pursue the first method permitted by the National Banking Act, namely, a tax on the value of the shares. For it seems perfectly clear that those States which have elected to pursue the third or fourth methods, namely, "to tax such associations on their net income", or "according to or measured by their net income" would be entitled to the tax, irrespective of share ownership.

Purely as a matter of statutory construction, taking into account the Congressional purposes in adopting Sec. 548 (R. S. Sec. 5219), and in the light of the previous construction placed upon said Section by this Court in *Bank of California v. Richardson,* supra, which was presumably known to Congress, an intent of Congress to extend governmental immunity to National Bank stock held by the Reconstruction Finance Corporation, cannot be implied.

CONCLUSION.

For all of the foregoing reasons we earnestly contend that the decision of the Maryland Court of Appeals should be affirmed.

Respectfully submitted,

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